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UNCLAS SECTION 01 OF 05 KATHMANDU 000479

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SUBJECT: RESPONSE: IMPACT OF RISING FOOD/COMMODITY PRICES -
NEPAL

REF: SECSTATE 39410

Introduction

1. Nepal's population is particularly vulnerable to food insecurity and the rising cost of food equates to increased hunger in Nepal. Over the last few decades Nepal has become a food deficit country. Yields per hectare have not kept pace with the population growth. In fact, Nepal has the lowest yield per hectare for rice and wheat in South Asia. Even during a good or normal harvest year, millions of families struggle to meet basic food needs. Nepal relies on imports from neighboring countries and foreign aid to meet the food gap. Nepal's food security has been further complicated by the temporary ban on the export of non-basmati rice and wheat the Government of India instituted to meet its own domestic demands.

1A. DEMAND

Essential Foods and Price Increases

2. Market prices for key commodities in Nepal -- including rice, lentils, pulses, wheat, cooking oil and various fruits and vegetables -- have risen sharply over the last few months, and the prices of many food items have doubled in the past year. For example, the retail price of short grain rice in December of 2007 was NRs 24 per kilogram; in March 2008 it was NRs 30. (Note: During this period, 1 USD was approximately NRs 63. End note.) In the same time period the price of most cooking oils rose by over 50 percent -- mustard oil in December of 2007 was NRs 102 per liter; in

March of 2008 it was 150 per liter. Soybean oil and sunflower oil have risen even more - going from NRs 95 and 90 to NRs 150 and 160 respectively. During the same period the price of chicken rose from NRs 130 per kilogram to NRs 165 per kilogram.

Nepal Is a Net Importer of Food

13. Nepal, a net importer of food, was only 81.7 percent self-sufficient in 2006/07, according to the World Food Program (WFP). The percentage of domestic consumption satisfied by domestic production varies by year and by district depending on the total cereal production. The cereal shortage in 2007 was estimated at approximately 225,000 metric tons because of the impact of drought and flood, particularly in the Terai (Nepal's southern plain areas). That much of the country is in deficit in food production is also evident in the very high prevalence of undernourishment that is found across the country. The WFP crop and food supply assessment found that an estimated 40.7 percent of Nepal's population is undernourished. Moreover, food consumption data from the Nepal Living Standard Survey indicate that the real food shortage may actually be much higher than what is calculated using crop production statistics. The impact of the lack of food is most obvious in Nepal's children. The last National Demographic Health Survey found that 39 percent of children under five were underweight. Chronic malnutrition affects 49 percent of the children under five in Nepal and wasting, a measure of acute malnutrition, has increased in the past five years to 13 percent. In some areas in the Terai, it is as high as 17

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percent, which is an emergency situation according to World Health Organization standards.

Coping Strategies

14. Nepal has relied heavily on India to fill its production gap, and the ban on the export of non-basmati rice and wheat the Government of India reinstituted in April 2008 to meet its own domestic demands has exacerbated the crisis in Nepal.

The WFP reports that many households are already adopting severe coping strategies that they would normally undertake only during lean seasons in a low crop production year: migrating earlier, selling assets, cutting the number of meals, using savings or seeking credit to purchase food, selling land and even taking children out of school. The poorest simply go without.

Who is Most Affected

15. Rising food prices will be most strongly felt in urban areas. But as most agricultural producers in Nepal are net food consumers (e.g. they consume more than they produce) the effect of rising prices will also be strongly felt in rural areas, particularly in those areas characterized by deeply embedded and widespread poverty and food insecurity. Those in the mid- and far-western regions of Nepal, who have little access to markets and rely almost solely on their own crop production, may be the least affected by market increases, but they remain extremely vulnerable to drought. In contrast, the most vulnerable populations in the Terai - including the landless, women and children - who rely heavily on the market will be the most affected by rising market prices.

1B. SUPPLY

Domestic Production Not Responding to Rising Prices

¶6. There is no evidence that domestic agricultural production is responding to changes in prices, nor has there been an increase in investment, domestic or foreign, in food production. The agricultural model and land used remain largely unchanged. Higher commodity prices in theory should lead to higher crop production and increase the income for local farmers. However, since the majority of farmers are deficit producers and have to buy, on balance, most of their food, the outcome is likely to be negative. With limited investment in the agricultural sector, low use of fertilizer and pesticides, lack of farm mechanization and unavailability of additional land to bring under cultivation, immediate increases in agricultural production are unlikely to take place.

Food Stocks

¶7. There is no change in the food inventories/stocks, and the Government of Nepal (GON) possesses limited buffer stocks of key staples through the Nepal Food Corporation (currently 4,000 metric tons of rice stored domestically, as part of the food security reserve of the South Asian Association for Regional Cooperation, with provisions to draw more from the regional reserve). The GON has limited capacity to manage or

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control buffer stocks. Should the situation worsen, the new government will face significant challenges to mounting an effective response to the domestic food crisis.

Political Instability and the Lack of Security Affect Supply

¶8. Political instability and the lack of security over the past decade created many bottlenecks in supply chains of almost all goods and services. The lack of electricity production capacity forced processing and manufacturing facilities to operate around a load-shedding schedule of up to 40 hours per week. In addition, many areas in the Terai experienced over 60 days of bandhs (strikes) in 2007 during which transportation and the movement of goods halted. The trickle-down effects included lower production, lost wages and lost profits. Higher input costs also affected food prices and production. In addition to rising energy and transportation costs, Nepal's traders have also raised the price of commodities to recoup money that in many cases they were forced to "donate" to various political parties.

Weather Severely Affects Supply

¶9. Weather is another factor severely affecting the food supply. Drought and other natural disasters in 2006 resulted in a national 13 percent cereal production deficit. In 2007, Nepal was hit again with drought and massive monsoon flooding, but the rice paddy harvest bounced back with an estimated 17 percent increase over the previous year's production. WFP reported in April 2008 that winter crop production levels were down by 20 to 40 percent in the hill and mountain districts of far- and mid-western Nepal. Crop production levels in these areas were worse in 2008 than in 2007, mostly because of lack of rainfall and damage from hailstorms. These poor production levels are likely to place further upward pressure on the prices of rice and wheat and will dramatically affect the nearly 8 million poor who rely upon the winter crop to cover their food needs until the summer harvest.

¶C. POLITICAL IMPACT

No Food Price Protests

¶10. There have not yet been public protests or violence in

response to rising food prices. Results from the April 10 Constituent Assembly (CA) election, in which the Communist Party of Nepal - Maoist outperformed every other party, indicate that the Nepali people expect change. If the new Maoist-led government is unable to respond effectively to the growing food crisis, protests, violence and continuing political instability would be likely. The most vulnerable populations in the Terai are largely members of low-caste and ethnic groups who have grown increasingly vocal and violent over the last year. These groups have for most of the past year been at odds with the Maoists and are likely to be demanding and impatient. Food scarcity would make the reintegration of internally displaced persons and Maoist ex-combatants into both urban and rural areas more difficult as establishing sustainable livelihoods becomes harder in the face of growing food unavailability.

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D. ECONOMIC IMPACT

Nepal a "Moderate Loser"

¶11. The World Bank has recently estimated that Nepal will be a "moderate loser" in terms of the impact of 2007-2008 food price increases on its trade balance -- meaning that Nepal is likely to lose less than one percent of GDP. Despite being a largely agricultural economy, the agricultural sector is deeply inelastic and is poorly positioned and slow to respond to agricultural price increases. In Nepal, agricultural production is likely to increase less than one percent for every ten percent increase in price given the many constraints that inhibit agricultural efficiency in the country and discourage investment.

Government Challenged To Handle Resources

¶12. The GON is facing rising trade and budget deficits -- in part from the high costs of the peace process and CA election -- and is finding it increasingly difficult to manage resources for even the most pressing priorities. The trade balance deficit, particularly with India, is large and increasing. Additional resources required to cover rising food prices are not available; rising food prices will therefore have serious effects on the overall economy.

E. ENVIRONMENTAL IMPACT

No Impact on Environment

¶13. Rising prices of food and other commodities in Nepal have yet to have an impact on the environment. There has been no change in levels of deforestation, the availability and quality of water, soil conservation, or related issues.

F. GOVERNMENT POLICY RESPONSE

Food Security a Priority for GON

¶14. The GON has committed itself to make both agriculture and food security a priority in its Interim Plan for the next three years; however, it has yet to develop a concrete plan of action. The GON is also considering implementing a wheat export ban of its own similar to the one India has imposed. The ban is likely to affect transfer of foreign wheat more than domestically produced wheat given the overall deficit in domestic wheat production. Whether the Maoist-led government will be able to achieve food security is questionable. Political challenges, aside, much of Nepal's crop land

remains rain-fed and prone to natural disasters -- which can severely impact crop production, food availability and access, particularly for the most vulnerable populations.

G. IMPACT ON POST PROGRAMS

Food for Bhutanese Refugees -----

15. Rising food prices are already having a significant

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effect on emergency operations in Nepal, most notably WFP's program to supply food to the 108,000 Bhutanese in refugee camps awaiting a durable solution to their situation. WFP is the sole provider of food to the camps, and the refugees are wholly dependent on their rations from WFP. WFP estimates that it will need an additional USD 8 million to meet current program needs in the camps for this calendar year, and USD 14.5 million total to meet the needs for all of its programs in Nepal. Seed prices are also affecting the UN Food and Agriculture Organization's recently-launched emergency agricultural support program.

USAID Agricultural Development -----

16. USAID has an ongoing agricultural development program working with poor farmers in Nepal's central, mid-western and western regions. The program helps farmers produce high-value crops with the use of micro-irrigation and a value-chain approach to enable farmers to take advantage of off-season opportunities. The overall goal of this program, which started in 2003, is to reach approximately 70,000 poor families (over 400,000 people) and increase their incomes by more than 50 percent by the end of the program in 2009. Plans are currently in place to develop a follow-on agricultural program. Addressing food insecurity in Nepal will be one of the areas considered in the new design. Furthermore, in FY2007 and FY2008, USAID contributed over USD 7 million of food through its Food for Peace Program to WFP for Nepal's most vulnerable populations.

H. POLICY PROPOSALS

Recommendation to GON -----

17. Post recommends that the GON focus on the effective allocation of resources in post-conflict development. The peaceful reintegration of ex-combatants into society will also be essential to economic growth that meets the expectations of the Nepalese people. The GON should improve infrastructure -- including rural roads, reliable electricity, and telecommunication networks -- to make the production and distribution of agricultural commodities more efficient.

Recommendation for U.S. Policy -----

18. Post suggests that Washington consider increasing funding available for existing and future agricultural and economic development projects in Nepal -- and other countries facing food shortages. Post does not have any recommendations for changes in U.S. policy toward Nepal in regards to food security.

POWELL